



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

JUL 17 2014

Uniform Issue List: 415.00-00

SE: T: EP: RA: TZ

Attention: ***

Legend:

System X = ***

State S = ***

Plan X = ***

Excess Plan X = ***

Board B = ***

Dear ***:

This is in response to correspondence dated September 24, 2009, as supplemented by correspondence dated September 10, 2010, January 3, 2011, February 27, 2013, and June 24, 2014, submitted on behalf of System X by its authorized representatives, in which a request for a letter ruling was submitted with respect to the applicability of section 415(m) of the Internal Revenue Code (Code) to an excess benefit plan (Excess Plan X) and the tax consequences related thereto.

The following facts and representations have been submitted under penalty of perjury in support of the rulings requested.

State S has established Plan X on behalf of its eligible employees, who are certain judges, justices, solicitors and circuit public defenders of State S. Your authorized representatives have represented that Plan X is a defined benefit plan, a governmental plan as described in section 414(d) of the Code, and is intended to meet the qualification requirements of section 401(a) of the Code.

System X, an instrumentality of State S, is the administrator of Plan X. Board B, a board comprised of officials of State S, is the Trustee of Plan X.

Contributions to Plan X are mandatory for participating employees and are equal to a fixed percentage of each participant's compensation. Plan X allows participants to make pre-tax elective contributions to Plan X to buy years of service credit in Plan X for eligible prior service in other specified public employment. These purchases of years of service credit may also be made by after-tax contributions, rollovers, or trustee-to-trustee transfers.

State S statutes provide for the establishment of qualified excess benefit arrangements within the meaning of section 415(m) of the Code. Pursuant to this authority, on September 23, 2009, Board B adopted and is planning to implement Excess Plan X for the benefit of employees of State S who participate in Plan X. Excess Plan X will operate in accordance with section 415(m) of the Code as a qualified governmental excess benefit arrangement. Employees who participate in Plan X will become eligible for benefits from Excess Plan X if their benefits calculated under the benefit formula are limited by section 415(b) of the Code as that section applies to government plans. Participation in Excess Plan X is mandatory and automatic for all participants in Plan X whose retirement benefits from Plan X are limited by section 415 of the Code.

Section 4.01 of Excess Plan X provides that a participant will receive a benefit equal to the amount of retirement income that would have been payable to, or with respect to, a Participant that could not be paid by Plan X because of the application of the limitations on his retirement income under section 415(b) of the Code. An excess benefit under Excess Plan X will be paid only if and to the extent the participant is receiving retirement benefits from Plan X. Section 4.01 of Excess Plan X will be amended to provide that no portion of benefits in excess of the Code section 415(b) limit paid to a participant can be attributable to service credit purchases made with picked-up employer contributions.

Excess Plan X will be administered by System X. Board B has established a separate trust fund for segregation of the assets related to Excess Plan X. The trust fund was established solely for the purpose of holding employer contributions intended to pay excess benefits to affected Excess Plan X participants. The trustees of this separate trust fund will be members of Board B. Your authorized representatives have represented in the correspondence dated February 27, 2013 that the trust fund is designed to constitute a grantor trust

under state law and for federal income tax purposes. Under the represented facts, Excess Plan X participants will receive no property right or interest in the trust assets, and the trust assets are subject to the claims of State S's general creditors in the event of insolvency.

Excess Plan X will be funded on a pay as you go basis. Board B will determine the amount necessary to pay the excess benefits under Excess Plan X for each plan year. The required contribution will be the aggregate of the excess benefits payable to all affected participants for such plan year in an amount determined by Board B to be a necessary and reasonable expense of administering Excess Plan X. The amount so determined will be paid by State S and deposited into the trust fund. Any contributions not used to pay the excess benefits for a current year, together with any income accruing to the trust fund, will be used to pay the administrative expenses of Excess Plan X for the plan year. Any contributions not so used that remain after the payment of administrative expenses will be used to fund administrative expenses or excess benefits of participants in future years.

Benefits under Excess Plan X will be paid only if and to the extent the participant is receiving benefits from Plan X. Participation in Excess Plan X will cease for any Plan Year in which the participant's benefit under Plan X does not exceed the requisite limitations of section 415(b) of the Code, or if all benefit obligations under Excess Plan X to the member, retiree or beneficiary have been satisfied. The form of the benefits paid to a participant from Excess Plan X will be the same form as the participant's retirement benefit under Plan X. A participant in Excess Plan X will be paid the amount of the benefit that would otherwise have been payable to the participant under Plan X except for the limitations of section 415(b) of the Code. The excess benefit to which a participant is entitled under Excess Plan X will be paid commencing during or with the month in which all monthly payments of retirement benefits under Plan X are paid. Under no circumstances will the participant be given any election to defer compensation under Excess Plan X, either directly or indirectly. In addition, under the represented facts, there will be no employee contributions to Excess Plan X.

Although Excess Plan X is a part of Plan X, no assets of Plan X will be used to pay any benefits under Excess Plan X. Excess Plan X is intended to grant a participant no more than a mere contractual right to payment of benefits under Excess Plan X. Employer contributions to Excess Plan X's related trust may not be commingled with assets of Plan X's related trust, nor may Excess Plan X receive any transfers from Plan X. Under no circumstances will employer contributions to fund the excess benefits under Excess Plan X be credited to Plan X.

Based upon the facts and representations stated above, the following rulings are requested:

1. Excess Plan X is a qualified governmental excess benefit arrangement within the meaning of section 415(m) of the Code.
2. The benefits payable under Excess Plan X will be includible in gross income for the taxable year or years in which such benefits are paid or otherwise made available to a participant or a participant's beneficiary in accordance with the terms of Excess Plan X.
3. Income accruing to Excess Plan X is exempt from federal income tax under sections 115 and 415(m)(1) of the Code as income derived from the exercise of an essential governmental function.

Section 415(b) of the Code and section 1.415(b)-1 of the Income Tax Regulations ("Regulations") set forth the limitations on annual benefits for participants in defined benefit plans.

Section 415(m)(1) of the Code provides that, in determining whether a governmental plan (as defined in section 414(d) of the Code) meets the benefit limitations of section 415 of the Code, benefits provided under a qualified governmental excess benefit arrangement shall not be taken into account. Section 415(m)(1) also states that income accruing to a governmental plan (or to a trust that is maintained solely for the purpose of providing benefits under a qualified governmental excess benefit arrangement) shall constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) shall be exempt from tax under section 115 of the Code.

Section 415(m)(2) of the Code describes the tax treatment of benefits payable under a qualified governmental excess benefit arrangement. Under section 415(m)(2) of the Code, the taxable year or years for which amounts in respect of a qualified excess benefit arrangement are includable in gross income by a participant, and the treatment of such amounts when so includible by the participant, are determined as if such qualified governmental excess benefit arrangement were treated as a plan for the deferral of compensation that is maintained by a corporation not exempt from tax and which does not meet the requirements for qualification under section 401 of the Code.

Section 415(m)(3) of the Code defines a qualified governmental excess benefit arrangement as a portion of a governmental plan that meets the following three requirements:

- (A) Such portion is maintained solely for the purpose of providing to participants in the plan that part of the participant's annual benefit otherwise payable under the terms of the plan that exceeds the limitations on benefits imposed by section 415 ("excess benefits");
- (B) Under such portion no election is provided at any time to the participant (directly or indirectly) to defer compensation; and

- (C) Excess benefits are not paid from a trust forming a part of such governmental plan unless such trust is maintained solely for the purpose of providing such benefits.

With respect to your first requested ruling, Excess Plan X was adopted by Board B as a part of Plan X. It has been represented that Plan X is a governmental plan as described in section 414(d) of the Code. It has also been represented that the only purpose of Excess Plan X is to provide affected employees who are participants in Plan X that portion of their benefits that would otherwise be payable under the terms of Plan X except for the limitations on benefits imposed by section 415(b) of the Code, as applicable to governmental plans. The terms of Excess Plan X limit participation to participants in Plan X for whom benefits would exceed the limits of section 415 of the Code. Therefore, we have determined that Excess Plan X is a portion of a governmental plan which is maintained solely for the purpose of providing to State S employees who participate in Plan X that part of the participants' benefits otherwise payable under the terms of Plan X that exceed the section 415 limits, and, as such, meets the requirements of section 415(m)(3)(A).

Your authorized representatives have stated that participation in Excess Plan X is mandatory and automatic, and that there are no employee contributions to Excess Plan X. Your representatives also assert that no direct or indirect election to defer compensation is provided to any participant in Excess Plan X. Thus, we have determined that no direct or indirect election is provided at any time to participants to defer compensation, and accordingly, the requirements of section 415(m)(3)(B) are met.

Section 415(m)(3)(C) of the Code requires that the trust from which the excess benefits are paid must not form a part of the governmental plan which contains the excess benefit arrangement, unless such trust is maintained solely for the purpose of providing such benefits. In this case, Excess Plan X will be funded on a pay-as-you-go basis. Board B established a trust fund for the segregation of assets related to Excess Plan X which is maintained separately from Plan X. This trust fund was established solely for the purpose of holding employer contributions intended to pay excess benefits to affected Plan X participants. Contributions to the trust fund will consist only of the amounts required to pay the excess benefits and administrative expenses for the plan year. Any contributions not used to pay the excess benefits for a current plan year, together with any income accruing to the trust fund, will be used to pay the administrative expenses of Excess Plan X for the plan year. Any contributions not so used that remain after the payment of administrative expenses will be used to fund excess benefits of participants or pay administrative expenses in future years. Therefore, we have determined that the requirements of section 415(m)(3)(C) of the Code are met.

Since Excess Plan X satisfies all of the requirements of section 415(m)(3) of the Code, we conclude, with respect to your first ruling request, that Excess plan X is a qualified governmental excess benefit arrangement within the meaning of section 415(m) of the Code.

Your second ruling request asks whether the benefits payable under Excess Plan X will be includible in gross income for the taxable year or years in which such benefits are paid or otherwise made available to a participant or a participant's beneficiary in accordance with the terms of Excess Plan X. In response to your first ruling request, we determined that Excess Plan X meets the legal requirements of section 415(m) of the Code and, therefore, constitutes a qualified governmental excess benefit arrangement. Accordingly, under section 415(m)(2) of the Code, the tax treatment of the amounts distributed under Excess Plan X to the participants is determined as if such qualified governmental excess benefit arrangement were a plan for the deferral of compensation which is maintained by a corporation not exempt from tax and which does not meet the requirements for qualification under section 401 of the Code.

Section 83(a) of the Code provides that the excess (if any) of the fair market value of property transferred in connection with the performance of services over the amount paid (if any) for the property is includible in the gross income of the person who performed the services for the first taxable year in which the property becomes transferable or is not subject to a substantial risk of forfeiture.

Section 1.83-3(e) of the Regulations provides that for purposes of Code section 83, the term "property" includes real and personal property other than money or an unfunded and unsecured promise to pay money or property in the future. Property also includes a beneficial interest in assets (including money) transferred or set aside from claims of the transferor's creditors, for example, in a trust or escrow account.

Section 402(b) of the Code provides that contributions made by an employer to an employee's trust that is not exempt from tax under section 501(a) are included in the employee's gross income in accordance with section 83, except that the value of the employee's interest in the trust will be substituted for the fair market value of the property in applying section 83. Under section 1.402(b)-1(a)(1) of the Regulations, an employer's contributions to a nonexempt employee's trust are included as compensation in the employee's gross income for the taxable year in which the contribution is made, but only to the extent that the employee's interest in such contribution is substantially vested, as defined in the Regulations under section 83 of the Code.

Section 451(a) of the Code and section 1.451-1(a) of the Regulations provide that an item of gross income is includible in gross income for the taxable year in which actually or constructively received by a taxpayer using the cash receipts and disbursements method of accounting. Under section 1.451-2(a) of the

Regulations, income is constructively received in the taxable year during which it is credited to a taxpayer's account, set apart, or otherwise made available so that the taxpayer may draw on it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Various revenue rulings have considered the tax consequences of nonqualified deferred compensation arrangements. Rev. Rul. 60-31, Situations 1-3, 1960-1 C.B. 174, holds that a mere promise to pay, not represented by notes or secured in any way, does not constitute receipt of income within the meaning of the cash receipts and disbursements method of accounting. See also Rev. Rul. 69-650, 1969-2 C.B. 106, and Rev. Rul. 69-649, 1969-2 C.B. 106.

Under the economic benefit doctrine, an employee has currently includible income from an economic or financial benefit received as compensation, though not in cash form. Economic benefit applies when assets are unconditionally and irrevocably paid into a fund or trust to be used for the employee's sole benefit. *Sproull v. Commissioner*, 16 T.C. 244 (1951), *aff'd per curiam*, 194 F.2d 541 (6th Cir. 1952), Rev. Rul. 60-31, Situation 4. Rev. Rul. 72-25, 1972-1 C.B. 127, and Rev. Rul. 68-99, 1968-1 C. B. 193, holds that an employee does not receive income as a result of the employer's purchase of an insurance contract to provide a source of funds for deferred compensation because the insurance contract is the employer's asset, subject to claims of the employer's creditors.

Based on the foregoing, with respect to the second ruling request, we conclude that the benefits payable under Excess Plan X will be includible in gross income for the taxable year or years in which such benefits are paid or otherwise made available to a participant or a participant's beneficiary in accordance with the terms of Excess Plan X.

With respect to your third requested ruling, section 415(m)(1) of the Code provides that income accruing to a governmental plan (or to a trust that is maintained solely for the purpose of providing benefits under a qualified governmental excess benefit arrangement) in respect of a qualified governmental excess benefit arrangement will constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) will be exempt from tax under section 115 of the Code. We have determined, in connection with your first ruling request, that Excess Plan X meets the legal requirements of section 415(m) of the Code for qualified governmental excess benefit arrangements. Therefore, under section 415(m)(1) of the Code, with respect to your third requested ruling, we conclude that income accruing to Excess Plan X is exempt from federal income tax under sections 115 and 415(m)(1) of the Code as income derived from the exercise of an essential governmental function.

No opinion is expressed as to the tax treatment of the transactions described herein under the provisions of any other section of either the Code or regulations which may be applicable thereto.

No opinion is expressed as to whether the trust fund established for the purpose of holding employer contributions intended to pay excess benefits to affected Excess Plan X participants constitutes a grantor trust under Rev. Proc. 92-64, 1992-33 I.R.B. 11. No opinion is expressed as to the tax treatment of the transactions described herein with respect to the trust holding the contributions under the provisions of any other section of either the Code or regulations which may be applicable thereto.

This letter assumes that Plan X is and was a governmental plan as described in section 414(d) of the Code, is and was qualified under section 401, and its related trust is and was exempt from tax under section 501(a) at all relevant times thereto.

This ruling is contingent upon the adoption of the amendments to Article III and Section 4.01 of Excess Plan X, as stated in the correspondence dated September 10, 2010 and June 24, 2014.

This letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this ruling letter is being sent to your authorized representatives.

If you wish to inquire about this ruling, please contact *** at (***) ***-****. Please address all correspondence to SE:T:EP:RA:T3.

Sincerely yours,

Laura B. Warshawsky, Manager
Employee Plans Technical Group 3

Enclosures:
Deleted copy of letter ruling
Notice of Intention to Disclose

cc. ***